ANNUAL REPORT 1988

MANITOBA TELEPHONE SYSTEM

With you all the way!

89-04950/

The Manitoba Telephone System has adopted as its Mission:

Its six Corporate Goals are:

To provide customer satisfaction

To be financially responsible and self-sufficient

To pursue market opportunities aggressively

To provide equal opportunities and an environment which develops employee competence, commitment and satisfaction

To be a good corporate citizen

To keep the public well informed

This Annual Report, the 81st since the System's inception, reflects this Mission and these Corporate Goals. They serve as the common theme linking the corporation's various activities and achievements.

At the same time, we're pleased to feature some of our customers — business people, residential subscribers, city folk and those living in smaller communities — to underline our first Corporate Goal — to provide customer satisfaction.

These customers are representative of the hundreds of thousands of Manitobans who depend on MTS telecommunications services to keep in touch whether it's across the road, across the nation or across the oceans.

COVER:

Regardless of where you live in Manitoba or what you do, MTS provides a range of products and services tailored to your personal or business communications needs.

For business people like Ann Gross, Loans Manager at the Assiniboine Credit Union's main branch in Winnipeg, the MTS telecommunications network is the gateway to a host of data communications services, electronic funds transfer applications, automated banking machine services and business communications systems that set the standard for convenience and reliability.

Inset:

Calling convenience and contemporary design are combined in these public telephones, precisely custom color matched to meet the architectural standards developed for Winnipeg's distinctive Eaton Place shopping promenade. "The challenge," one MTS representative explained, "was much like ordering your new station wagon from the factory and having it painted to match your nail polish exactly."

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ANNUAL REPORT

For the 12 months ended December 31, 1988

MANITOBA TELEPHONE SYSTEM

With you all the way!

THE MANITOBA TELEPHONE SYSTEM

(As at December 31, 1988)

The Honourable Glen Findlay
Minister responsible for
The Manitoba Telephone Act

Board of Commissioners

SEATED: (left to right)
Patricia Graham (Vice-Chairman)
Joanne Swayze

STANDING: (left to right)
Roy McMillan
Tom Stefanson, C.A.
Helmut Pankratz, MLA
Holly Beard
Paul Thomas (Chairman)
Rubin Spletzer

MISSING
Edgar Penner

Executive Officers

Reg Bird
President & C.E.O.

Dennis Wardrop
Executive Vice-President

Bill Fraser
Vice-President Finance

John Milne
Vice-President
Corporate Services

Denis Sutton
Vice-President
Human Resources

Brian McCallum
Vice-President
Business Communications

Roger Ballance
Vice-President
Marketing &
Strategic Planning

Barry Deakin
Vice-President
Customer Services

Barry Gordon
Vice-President
Network Development
& Operations

Doug Delgatty
Vice-President
Western Region

Ted Scoles
Vice-President
Northern Region

Ed Tinkler
Vice-President
Eastern Region

1988 HIGHLIGHTS

OPERATIONAL

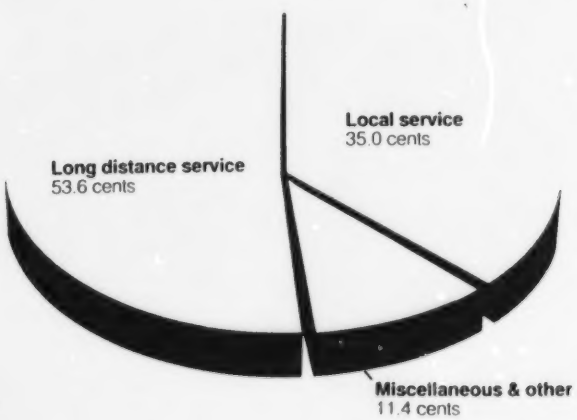
- The number of new main stations (telephones) in service increased by 5,411 and now totals 534,819.
- On average, the System handled 5,779,000 local calls and 288,000 long distance calls daily, increases of 5.4% and 8.3% respectively over year-previous averages.
- Fifteen more exchanges were converted to digital switching technology.
- Sales of optional calling convenience features such as call forwarding, call waiting and speed calling increased by 50% compared to 1987 figures.
- Long distance traffic volumes increased by 8.7% to 105,539,000, of which 89.1% were direct dialed.
- Automatic Number Identification (ANI) was expanded to encompass almost 96% of subscribers.
- Outright equipment sales in Winnipeg exceeded 1987 levels by 70%.
- A total of 66 communities, comprising 82.3% of Manitoba's population, have access to cable television service through MTS-supplied facilities.

FINANCIAL

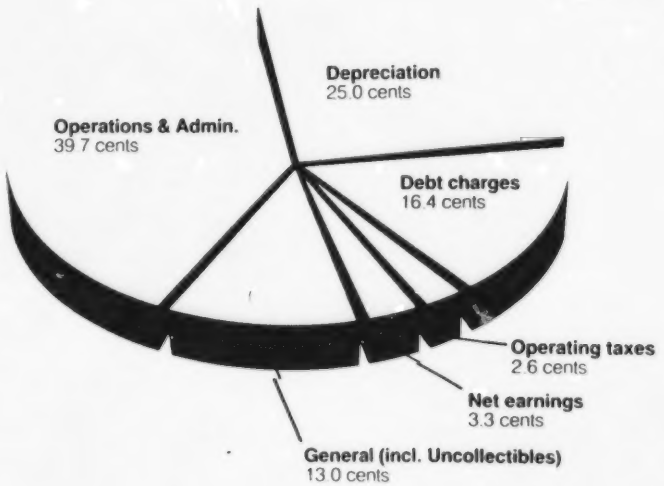
Value of telephone plant	$1,503,519,000
Operating Revenues	454,565,000
Operating Expenses	380,773,000
Net Earnings For the Year	15,445,000

THE MTS DOLLAR

Where Each Dollar Came From:



Where Each Dollar Went:



CHAIRMAN'S REPORT

Within a rapidly changing industry like telecommunications, there is a need to anticipate future developments in technology, the economy and regulatory policy. A strong sense of direction, openness to change and adaptability are qualities organizations like MTS must exhibit.

To this end, the MTS Board of Commissioners approved a Mission and Goals statement for the corporation. It is meant, in part, to provide a unifying sense of direction and purpose and is displayed prominently in all MTS locations.

The corporation also participated with the Government of Manitoba in announcing on September 29, 1988, the "Service for the Future" program, which is designed to provide Manitobans with a new standard of telephone service appropriate to the arrival of the 21st Century. This bold, ambitious, multi-year program will see party lines eliminated in rural Manitoba; an expansion in the size of toll-free calling areas throughout the province; and universal digital switching technology in all Manitoba exchanges to improve reliability, offer a broader selection of customer conveniences and extend the network's data communications capability throughout the province.

Important elements of "Service for the Future" are provisions to improve the corporation's financial situation by reducing our debt-equity ratio, dealing with our unfunded pension liability and earning a more equitable share from the Revenue Settlement Plan distributed by Telecom Canada.

Facing the prospect of increased competition, MTS is committed to reducing its current financial obligations, becoming more efficient and productive and competing aggressively in markets where competition is allowed.

The financial statements contained in this Report show net earnings for 1988 of $15.4 million. Further financial improvement is expected in future years.

Changing technologies and the possibility of deregulation will enable our customers to take their business elsewhere if MTS does not meet their expectations. Providing quality products and superior service must, therefore, become the corporation's primary goal.

MTS has an impressive record in terms of the reliability and quality of its service. This year's Annual Report reflects our orientation towards outstanding customer service.

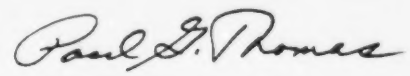
The past year has been a busy one for the MTS Board of Commissioners. Fifteen full Board meetings were held, including one in Thompson. In addition, the Board's five subcommittees met on several occasions and participated in public information meetings around the province to report on developments and plans for those communities.

The Board participated in the development of MTS Cellular and continues to monitor progress as it maintains its position as Manitoba's dominant cellular network provider. The Board also approved a Human Resources strategy for the corporation, including a pro-active Employment Equity plan.

It is also continuing to monitor the changing federal-provincial scene for possible changes in jurisdiction, policy and regulatory rules.

During the year, there were a number of appointments to the Board which are reported elsewhere. On behalf of MTS and personally, I would like to thank the six individuals who served on the Board until June, 1988, for their dedicated and constructive contribution to the corporation and to the people of Manitoba.

On behalf of the Board of Commissioners, I thank President Reg Bird, his Executive team and employees throughout the organization for the respect and support they have given the Board during the year. MTS's 1988 accomplishments are in large part the result of the efforts of over 5,000 employees throughout the company in all parts of the province. The Board of Commissioners extends its thanks and congratulations to our employees for a job well done. We look forward to working with you to build a better telecommunications future for all Manitobans.



Paul G. Thomas
Chairman

PRESIDENT'S REPORT

The year 1988, my first full year as MTS's President and Chief Executive Officer, has been one of growth, expansion and diversification. At the same time, it has been a period of planning and decision-making as we developed business strategies to guide us in meeting Manitoba's future telecommunications challenges.

During the last few decades, telecommunications technology has evolved at blinding speed. At the same time, our industry faces a future of unprecedented competition as telephone companies balance the responsibility of providing high quality basic service at reasonable costs with carving out a profitable share of the non-regulated telecommunications market.

Our corporate challenge is to modernize our network so it provides high quality services in a financially responsible manner to all Manitobans, regardless of where they live.

We made significant progress in meeting this challenge during 1988. Total operating revenues of $454,565,000 produced net earnings of $15,445,000. These provide the financial resources to offset rising capital costs, provide new services and expand our province-wide telecommunications network.

As a crown corporation, we are accountable to the people of Manitoba. We recognize that obligation. And, to constantly remind ourselves of it, we created a Mission Statement and a series of Corporate Goals which guide the corporation in its daily operations.

The Mission and Goals Statements are the benchmarks against which we measure our corporate performance. They represent our commitment to providing outstanding service to the people of Manitoba.

During 1988, this commitment was fulfilled in many ways by many people including our operators, who handled more than 105 million long distance calls, our business operations group, which introduced a multitude of new products and services, and our repair and installation technicians, whose efforts have resulted in a significant improvement in reducing lead times.

Outstanding service must be complemented by superior telecommunications products and services, a number of which were initiated in 1988 in response to a wide range of customer needs. These included:

- MTS Cellular, which was launched in Winnipeg on May 6 and encompasses a service area ranging from Clearwater Bay to the east to communities 25 miles west of Brandon and from the Lake Winnipeg beaches in the north to the U.S. border.
- In September, 1988, we introduced the most comprehensive service improvement program ever undertaken in Manitoba, "Service for the Future," part of our commitment with the Government of Manitoba to bring state-of-the-art telecommunications to all Manitobans.

The past year saw a re-dedication of our commitment to service, one summed up in our new core value statement -- "With you all the way!" These five words will set the tone for all our projects, operations and services in 1989 and the years to come.

On behalf of the MTS Executive, I want to thank the Honourable Glen Findlay, Minister responsible for The Manitoba Telephone Act; Paul Thomas, Chairman of the Board of Commissioners; and the Commissioners for their support and counsel. And, I thank the more than 5,200 MTS employees throughout the province who contributed to the corporation's achievements in 1988.

Reg Bird,
President and Chief Executive Officer

MTS
MANITOBA TELEPHONE SYSTEM
With you all the way!
MTS MISSION
To meet the telecommunications needs of all Manitobans with the right solutions, outstanding service, and superior products.
MTS CORPORATE GOALS
SX-50

MTS's commitment to customer satisfaction is exemplified in one of MTS's major 1988 business communications initiatives, a comprehensive communications analysis for Winnipeg's Health Sciences Centre to evaluate existing voice and data systems and recommend new systems to better meet the Centre's changing and expanding telecommunications needs.

During discussions with HSC officials, MTS Chairman Paul Thomas (right) and MTS President and Chief Executive Officer Reg Bird (left) hosted Health Sciences Centre President Rodney Thorfinnson during a tour of MTS's Empress Street Business Centre.

FINANCIAL SUMMARY

In accordance with Order-In-Council 1197/87, dated October 14, 1987, the fiscal year of The Manitoba Telephone System was fixed at December 31 in each year. Because of this change, the summary of changes in operating results between the nine month period ended December 31, 1987, and the twelve months ended December 31, 1988, would not be meaningful.

Net earnings for the twelve months ended December 31, 1988, was $15,445,000 compared with net earnings of $1,947,000 for the nine month period ended December 31, 1987.

Total property values as at December 31, 1988, were $1,503,519,000 and represents an average investment in plant per main telephone of $2,811, an increase of $37 during the year.

The Board approved an increase in investments held for pension obligations of $34,953,000 (including investment income of $4,030,000) to offset the increase in the pension liability appearing under deferred employee benefits.

The significant decrease in deferred charges from $39,499,000 to $12,030,000 is primarily due to the improvement in the unrealized foreign currency losses related to long-term debt and reflects the strengthening of the Canadian dollar relative to the U.S. dollar and Swiss franc during the year.

Net borrowings during the year consisted of additional long-term debt of $22,000,000. Long-term debt of $25,000,000 was retired during the year, with $3,000,000 of this repayment being provided by the Sinking Fund. Contributions to the Sinking Fund of $9,870,000 were made as required under The Manitoba Telephone Act.

Reinvested earnings totalled $87,355,000 at December 31, 1988, as a result of net earnings for the year of $15,445,000.

OPERATIONAL REVIEW

The Manitoba Telephone System's performance during 1988 reflected the general stability and moderate growth levels that characterized most sectors of the provincial economy. At the same time, it experienced the effects of a general slow-down in the home-building industry and the net outward population migration. As a result, a modest gain of just over 1% was experienced in the total telephones in place.

The most noteworthy 1988 MTS achievement was a return to higher net earnings. The company realized net earnings of $15,445,000 during the 12 months ended December 31, 1988, on total operating revenues of $454,565,000 and operating expenditures of $380,773,000.

At year end, the value of telephone plant was $1,503,519,000, an increase of 2.4% over the $1,468,737,000 reported for 1987.

Telephone calling statistics continued to reflect the steadily upward trends established over the past five years. During the year, the System handled an average of 5,779,000 local calls and 288,000 long distance calls daily, increases of 5.4% and 8.3% respectively compared to 1987 daily averages.

On December 31, 1988, a total of 66 communities comprising 82.3% of Manitoba's population had access to cable television service through MTS-supplied facilities.

MTS telecommunications also provide the vital links which Manitoba's newest television station, The Manitoba Television Network (MTN Channel 13), depends upon to bring images of the world into its Portage la Prairie studio and out into viewers' homes.

MTN Manager Drew Craig credits the station's close working relationship with MTS's Broadcast Industry Group as a key factor in the station's ability to serve its diverse rural and urban audience from its main Portage la Prairie studios and news bureaus in Winnipeg, Brandon, the Manitoba Legislature and the Winnipeg Commodity Exchange.

The Mission embodies MTS's commitment to its customers and the achievements described in this Report are presented in this context

The "Service for the Future" program, announced on September 29, 1988, was one of the major programs introduced to meet the

telecommunications needs of all Manitobans. The program has four goals:

- To initiate a province-wide service improvement program to provide all Manitobans the convenience of individual line service by 1996; to convert all exchanges in the province to digital technology by 1996; to reduce the number of toll-free calling areas in the province from 160 to 60 by 1996; and to introduce an Extended Urban Service in 1990 to allow subscribers in the Brandon and Winnipeg fringes to subscribe to toll-savings plans.
- To better serve subscribers with physical disabilities.
- To earn a more equitable share of Telecom Canada inter-provincial long distance revenues.
- To position MTS to operate more effectively in a competitive marketplace.

To help finance the "Service for the Future" program and offset future inflationary pressures, the System applied to The Public Utilities Board of Manitoba on October 3, 1988, for rate increases to generate an additional $13.9 million in 1989 and $27.8 million in 1990. The PUB's decision on this application is expected early in 1989.

The PUB was also asked on May 30, 1988, to approve the creation of a new rate group for the Winnipeg exchange because the count of telephone numbers that could be reached without incurring long distance charges exceeded the existing rate group's level of 375,000. The PUB approved the application on November 3, 1988. As a result, a new Rate Group 10 was created for Winnipeg with new thresholds from 375,001 to 500,000. As a consequence of that approval, monthly rates for basic rotary dial services in Winnipeg will increase on January 1, 1989, by 45 cents for residential customers and $1.15 for basic business service.

A request was also made for the PUB to approve reductions of up to 12.8% on calls placed from Manitoba to other North American points. The PUB issued an interim order on this request for reductions effective January 1, 1989.

During the period under review, MTS engineers, technicians, construction crews and administrative staff completed a number of significant projects to enhance service quality in communities throughout the province.

An additional 15 exchanges were converted to digital switching technology which offers significant benefits and access to a wide range of optional calling conveniences such as call forwarding, call waiting and speed calling. During the reporting period, almost 14,000 customers selected one or more of these calling convenience features, a gain of 50% over the previous year.

During 1988, MTS Business Communications offered customers a variety of innovative telecommunications products and services, many of which provide features previously available only on larger, more complex business systems.

For Dave Dueck, Manager, Information Systems for McMahon Canada Ltd., a Winnipeg-based distributor of carpeting and floor-covering materials, new telecommunications technology simplifies ordering and inventory control. MTS designed a custom iNet 2000 application, MCMAHON.NET, which allows McMahon's customers to use their computer terminals for direct access into the McMahon computer and quick responses on product information and availability requests.

During the year, projects were undertaken on the fibre optic (FOTS) network to provide additional capacity and improve service quality. The largest project saw completion of the 618km fibre optics cable network between the Ontario and Saskatchewan borders, part of Telecom Canada's trans continental fibre optics system.

Other significant FOTS installations included linking various Winnipeg offices with fibre optics to provide an additional 10,800 communications channels. FOTS projects were also completed in the Boissevain-Minto-Brandon, Bowsman-Swan River, Inglis-Russell and Selkirk-Grassmere-Grand Beach areas.

During 1988, long distance services generated revenues of $253,741,000 which represented 53.6% of total revenues. Long distance traffic volumes increased by 8.7% to 105,539,000 calls, 89.2% of which were direct dialed. On-going programs to provide customers more convenient access to the long distance network continued. During 1988, 12 more exchanges were converted to ANI. Nearly 96% of all MTS customers are now served by Automated Number Identification (ANI) and 93.7% have "O+" service.

MTS continues to enjoy one of the highest levels of TouchTone penetration in North America at 59% of the stations in service. Northern Region attained a 74% TouchTone level; Winnipeg was at 64%.

Particular emphasis was placed on installation and repair service improvements. By introducing new wiring systems and techniques and adopting a pre-jacking policy, lead times on installations and repairs were reduced significantly. Callers to the Winnipeg Repair Centre are now being answered within 20 seconds 80% of the time; due dates for service relocations during Winnipeg's prime moving period were reduced from 2.2 days in 1987 to 1.7 days in 1988; and installation requests from the small business market are now being fulfilled within five days rather than the previous two-to-four-weeks.

To reinforce the Mission Statement, the company adopted a core value statement, "With you all the way!" to be incorporated into advertising and promotional materials to remind managers and employees of the Corporate Goals and position MTS as a company customers can count on.

Long distance rate reductions and continuing expansion of programs like 0+ dialing and Automated Number Identification (ANI) which provide more convenient access to the long distance network contributed to an increase of 8.7% in long distance calling in 1988. Manitobans placed a total of 105,539,000 long distance calls during the year, of which more than 89% were direct dialed.

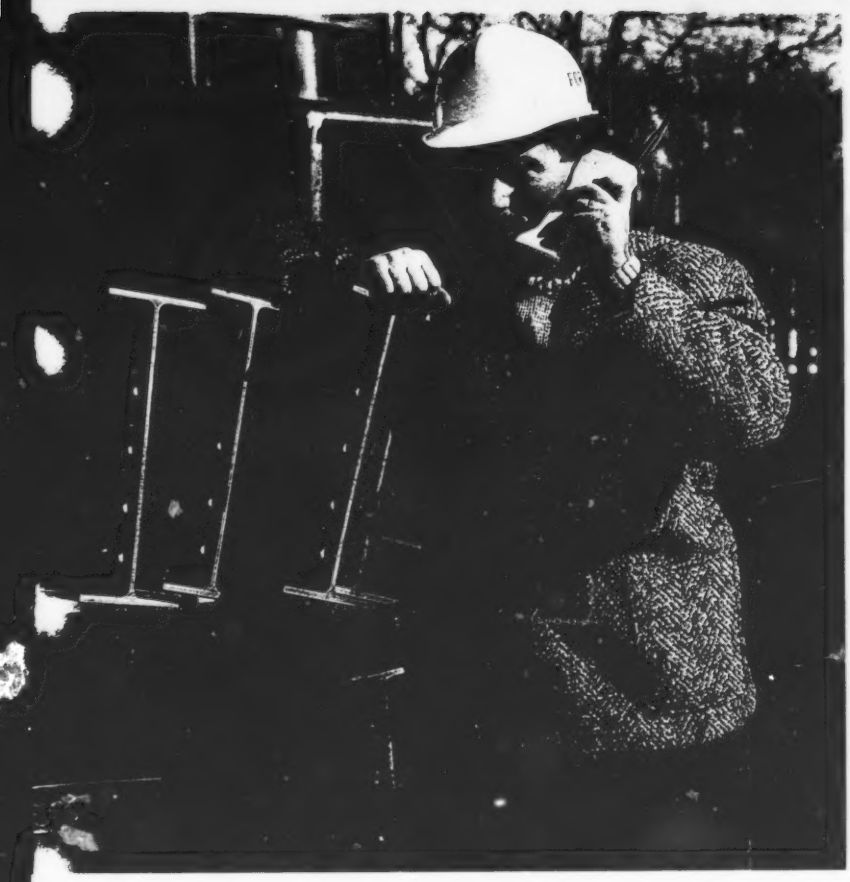
The convenience and economy of direct dialing to overseas points has particular appeal for Raphael and Beatrice Grèban-de-St. Germain, their son, Xavier, and daughter, Coralea. As they establish themselves in their new Winnipeg home, the telephone is their link with family and friends overseas in Belgium and France.

MTS Corporate Goals

To provide customer satisfaction

In September, MTS commissioned Angus Reid Associates to conduct a comprehensive survey to determine how MTS customers perceived the company, what they expected from it and how well they felt it was serving their needs. The survey involved 803 residential customers, 606 business customers and representatives of 51 of the company's largest customers.

The majority of customers — 80% within the residential group and 71% of the business people — were very positive about MTS's service. However, the company did not fare as well on opinions concerning its image. Only 58% of the residential sample and 33% of the business



When MTS Cellular was launched in Winnipeg in May, 1988, Pat Meagher, a partner in Forum Construction Ltd., was one of the first subscribers. "We're a small company," he says, "and we're always on the move. Cellular service gives us the mobility and flexibility we need. And MTS Cellular offers the best service and coverage."

Since its introduction, MTS Cellular has captured 65% of the competitive Manitoba cellular communications market. By year end, the MTS Cellular service area extended from Clearwater Bay on Lake of the Woods to the east, to communities 25 miles west of Brandon, and from the Lake Winnipeg beaches to the U.S. border.

sector reported positive attitudes in this category.

In response to those survey results, the company introduced a number of Customer Care programs to encourage more personalized service, improved response times on requests for service, more employee development in customer relations skills and incentive campaigns.

MTS's commitment to customer satisfaction also spurred the introduction of the Manitoba Relay Service (MRS), a service designed to open a world of communications between hearing and hearing-impaired people. With MRS, specially trained MTS operators act as the communications links between deaf and hearing people. The service is provided free of charge 24 hours per day.

To be financially responsible and self-sufficient

MTS's positive bottom line in 1988 is proof of its ability to meet this goal. At the same time, provisions within the "Service for the Future" program to fund more of the company's pension liability and reduce its debt ratio provide a framework to ensure future profitability in an increasingly competitive telecommunications marketplace.

To pursue market opportunities aggressively.

The introduction of MTS Cellular service to the Winnipeg market on May 6, was a major 1988 initiative towards attaining this goal. Since its introduction, MTS Cellular has exceeded its market projections and has captured 65% of the market share for this innovative communications service.

By the end of 1988, MTS Cellular service areas encompassed those Manitoba communities which represent more than 75% of Manitoba's population. In effect, this rapid coverage area expansion compressed a three-year program into nine months and positioned MTS Cellular as Manitoba's dominant cellular network provider.

The company's Phone Centres also adopted a more aggressive marketing approach and achieved record levels of outright equipment sales. Sales in Winnipeg during 1988 were 70% ahead of 1987 figures, the result of innovative sales campaigns to inform customers of new products and introduce them to existing telecommunications solutions.

Within the Business Communications sector, MTS representatives achieved a number of important marketing goals. Major customers who upgraded their systems included leading Manitoba companies such as UNISYS, Delta Inn, Northern Telecom, Assiniboia Downs, Federal Pioneer, Cadham Provincial Laboratory and Comcheq.

The combination of innovative products like the Meridian Norstar™ key systems (about 100 of which were sold within two months of their introduction) and customer-oriented incentive programs such as the popular Extended Rental Agreement program (which offers discounts on contract renewals plus assurance of rate stability during the extended contract term) contributed to a strong Business Communications marketing performance in 1988.

Centrex service, always popular with medium and larger-sized companies, received attention from smaller customers operating from various locations and requiring a

In 1988, directory advertising contributed $24,203,000 to MTS's positive 1988 net earnings and once again demonstrated its value as a powerful, cost-effective advertising medium.

Michael Brousseau's Southwood Supper Club in Fort Garry offers a complete range of wedding services including civil or religious ceremonies, bridal accessories, photography, flowers, reception catering and even honeymoon travel arrangements under one roof.

His advertising strategy: Yellow Pages.

"We list under every heading that has something to do with weddings," he says. "There's not a bride or groom who doesn't check the directory when shopping for wedding services. When they do, they see us."

coordinated central telecommunications system. The Manitoba Public Insurance Corporation (MPIC), CN Rail and Acklands were among the companies opting for Centrex during the year.

Among the more specialized services MTS successfully provided was a teleconferencing application developed for Red River Community College. The system enables Child Care Training instructors to conduct seminars in 25 locations across the province from sessions originating in Churchill, Lac du Bonnet and Winkler.

For MTS's Broadcast Industry Group, 1988 will be remembered as a year during which the demands of both a Federal and Provincial election generated orders for a wide array of services. These included video feeds between Brandon, Dauphin, Selkirk and Winnipeg; portable and long haul microwave facilities; FM broadband services on coaxial cable; and satellite communications support.

During the year in review, MTS also negotiated a new 25-year coaxial cable distribution agreement with Greater Winnipeg Cablevision; established a local CATV broadband network in Churchill (the most northerly installation in Manitoba); and renewed a contract with Relay Communications to extend CKY-TV's video/audio feed to Brandon using a new fibre optic transmission system.

On December 31, 1988, a total of 66 Manitoba communities comprising 82.3% of the province's population were eligible to receive cable television service through MTS-supplied facilities.

To provide equal opportunities and an environment which develops employee competence, commitment and satisfaction.

On June 16, 1988, The Honourable Glen Findlay, Minister responsible for The Manitoba Telephone Act, announced five new appointments to the MTS Board of Commissioners — Vice-Chairman Patricia Graham of Newdale; Holly Beard of Thompson; Rubin Spletzer of Winnipeg; Tom Stefanson of Winnipeg; and Helmut Pankratz, MLA, of Steinbach. On June 22, the appointment of Commissioner Edgar Penner of Kola was announced.

The appointments, the Minister noted, reflected a sound urban/rural representation. "This," he said, "is an important consideration if the Board is to successfully meet technical and structural changes and, at the same time, its traditional public service obligations to rural Manitobans."

The same consideration to meet technical and structural changes was reflected in the extensive

reorganization within the MTS Executive which took place during the period under review. Dennis H. Wardrop was appointed Executive Vice-President, the position he had held in an acting capacity since 1986; Bob C. Vannevel assumed new responsibilities for special projects reporting directly to the President and CEO; and John Milne was appointed Vice-President—Corporate Services. Roger Ballance, formerly Market Development Manager, was appointed Vice-President—Marketing and Strategic Planning and Denis Sutton was appointed Vice-President — Human Resources (a new position) with direct responsibility for fulfilling employee-related corporate goals.

Ms. Heather Nault was appointed Corporate Secretary/Board Analyst reporting directly to the Chairman.

On August 19, the Board approved a number of organizational changes within the Corporate Services and Human Resources areas. Responsibility for Legal, Security and Property Acquisition was transferred to the Vice-President — Corporate Services.

At the same time, the Vice-President—Human Resources accepted responsibilities for the Public Relations Department and a new Corporate Equity Department to coordinate Equal Employment Opportunity (EEO) programs, investigate human rights complaints and administer other related programs.

Pay Equity

During 1988, the second and final phase of the pay equity process was completed in accordance with The Manitoba Pay Equity Act, which is based on the principle of equal pay for equal work regardless of gender. On September 7, MTS and its three unions signed an agreement providing for pay equity wage adjustments to be implemented over a four-year period.

The agreement will raise the salaries of approximately 2,000 female and male employees working in female-dominated job classes.

Collective Agreements

On April 1, 1988, MTS and the C.W.C., representing operator services and clerical employees, signed a tentative three-year agreement, later ratified by union members, providing for wage increases of 3% in the first year, 3% in the second and a Consumer Price Index adjustment in the third year. The agreement also provided improved shift differential premiums, vacation periods and board and lodging compensation levels.

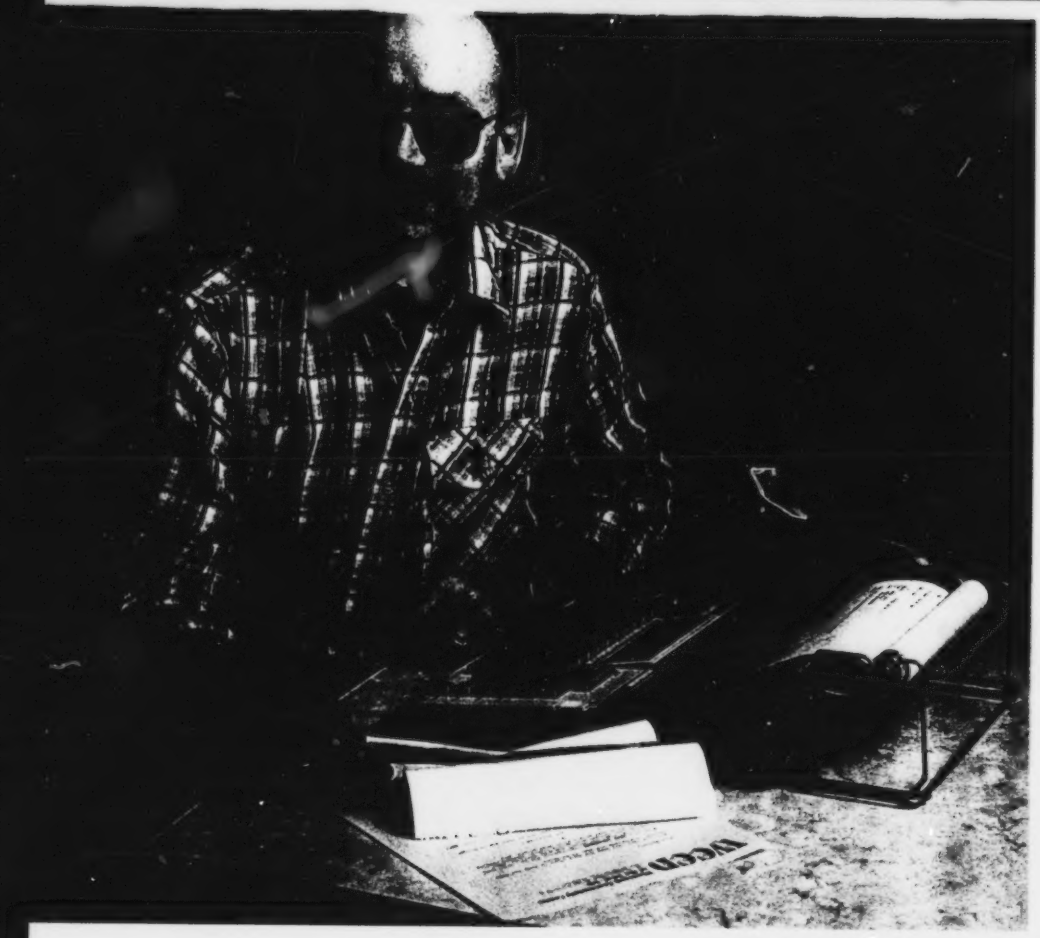
A three-year agreement providing similar wage and benefit improvements was negotiated with the I.B.E.W. Local 435 representing all MTS craft employees on April 25, and subsequently ratified by union members.

On December 31, 1988, a total of 5,212 full and part-time employees were employed by the System in various locations throughout the province.

MTS's "Service for the Future" program, announced in September, 1988, has, as one of its objectives, a province-wide rural service improvement component to provide all subscribers the convenience of individual line service by 1996, regardless of where they live.

For rural business people like Bob Small of Small Seeds Ltd., in Beausejour, the Individual Line Service program will mean greater privacy, access and convenience for him and some 47,000 rural MTS subscribers now using multi-party lines.

And, for Bob Small, those benefits are imminent. Beausejour is one of the first communities scheduled to be converted to Individual Line Service in 1990.



Independence.

That's the one word Dennis Zimmer uses to sum up the effect MTS's Manitoba Relay Service and his TDD (Telephone Device for the Deaf) has had on his life.

"Before," he explains in sign language, " if I wanted to have a conversation with someone, I had no option but to drive over to their house. Now all of my friends have a TDD; there are three units in the plants at Boeing, where I work; and I can communicate with anyone in the world."

Introduced in 1988, the Manitoba Relay Service opens up a new world of communications between hearing and hearing-impaired people. Specially-trained MTS operators act as communications links between deaf and hearing people by transferring the spoken word into written messages as the conversation proceeds. MRS service is free and available 24 hours per day.

To be a good corporate citizen

Telephone people have long recognized their responsibilities in achieving this corporate goal through their collective contributions to community charitable appeals and their individual involvement in a variety of voluntary activities to improve the quality of life in the community.

This spirit is exemplified in the Telephone Pioneers of America (Chapter 50) which celebrated its 50th Anniversary during 1988. The Pioneers are a group of active and retired telecommunications people who share their technical skills to develop learning and communications tools for people with disabilities.

Corporate contributions during the year were directed towards numerous charitable appeals in the communities in which MTS operates. The company is one of Manitoba's leading corporate contributors to the United Way campaigns; supports the Canadian Red Cross through blood donor clinics; and provides financial assistance to a variety of cultural organizations including the Royal Winnipeg Ballet. Many charitable groups also receive financial support from MTS employees through the Employee Charity Trust.

To keep the public well informed

During 1988, in accordance with the provincial Crown Corporations Accountability Act, the MTS Board and Executive took part in public information meetings at Cross Lake, Thompson, Carman, St. Vital and Deloraine to report on MTS developments and plans in those communities and discuss customer concerns. The company also introduced quarterly financial reports in compliance with the Act.

In a continuing program to provide public information, timely media alerts concerning service interruptions and possible traffic disruptions were provided; an innovative "Call Before You Dig" program to encourage contractors to eliminate one of the major causes of service disruption was completed; and a broad pro-active public affairs strategy was defined to improve the public's perception of MTS as a company they can count on.

ACKNOWLEDGEMENTS

The Board of Commissioners expresses its appreciation to all members of the MTS Executive who contributed to the positive performance the System achieved in 1988.

The Commissioners and Officers also take this opportunity to recognize the contributions of all MTS employees whose efforts and skills continue to bring credit to the System and the telecommunications industry.

FINANCIAL STATEMENTS

Management's Report

The integrity and objectivity of the financial statements and accompanying notes in the annual report are the responsibility of management.

To fulfill this responsibility, The Manitoba Telephone System maintains internal control systems to provide reasonable assurance that the books and records, from which the financial statements are derived, accurately reflect all transactions and that established policies and procedures are followed. The internal control systems are supported by regular reviews by internal auditors and by examination of the financial statements by Touche Ross & Co., independent chartered accountants.

The responsibility of the Board of Commissioners for the statements is pursued principally through its Audit Committee, which meets periodically with management and the internal and external auditors, to review accounting principles and practices.

The external auditors have full access to the Audit Committee both with and without management present. Their report, which provides an independent review of the system of internal controls and the compliance of the statements to generally accepted accounting principles, follows.

On behalf of the management:

President and Chief Executive Officer

Vice-President — Finance

Auditors' Report

To the Board of Commissioners,
The Manitoba Telephone System.

We have examined the balance sheet of The Manitoba Telephone System as at December 31, 1988 and the statements of operations and reinvested earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1988 and the results of its operations and the changes in its financial position for the year then ended in accordance with accounting principles described in Note 1 to the financial statements applied, except for the change in the method of accounting for station connections as described in Note 2 to the financial statements, on a basis consistent with that of the preceding period.

Touche Ross & Co.

Chartered Accountants

Winnipeg, Manitoba,
March 6, 1989

THE MANITOBA TELEPHONE SYSTEM

BALANCE SHEET AS AT DECEMBER 31, 1988

ASSETS

	1988	1987
	(in Thousands of Dollars)	
TELECOMMUNICATIONS PROPERTY		
Buildings, plant and equipment	**$1,445,008**	$1,393,257
Less Accumulated depreciation	**688,368**	692,406
	756,640	700,851
Land	**6,025**	5,952
Plant under construction	**35,320**	49,032
Materials and supplies, at cost	**17,166**	20,496
	815,151	776,331
INVESTMENTS (Note 4)	**999**	999
INVESTMENTS HELD FOR PENSION OBLIGATIONS (Note 10 (b))	**100,302**	65,349
CURRENT ASSETS		
Short term investments	**46,200**	41,612
Accounts receivable (Note 5)	**53,422**	53,124
Prepayments	**7,842**	7,597
	107,464	102,333
DEFERRED CHARGES		
Unrealized foreign currency losses, net of amortization	**5,094**	30,582
Unamortized long-term debt costs	**3,716**	4,513
Preliminary engineering and miscellaneous	**1,870**	2,638
Deferred employee benefit costs, net of amortization	**1,350**	1,766
	12,030	39,499
	$1,035,946	$ 984,511

Approved on behalf of the Board

Paul E. Thomas
Chairman

Patricia Graham
Commissioner

See accompanying notes to financial statements.

STATEMENT I

LIABILITIES AND REINVESTED EARNINGS

	1988	1987
	(in Thousands of Dollars)	
LONG-TERM DEBT (Note 11)	**$ 776,946**	$ 804,055
Less Sinking fund investments	**64,449**	57,144
	712,497	746,911
DEFERRED EMPLOYEE BENEFITS		
Pensions	**100,302**	65,349
Vested sick leave	**16,616**	15,342
	116,918	80,691
CURRENT LIABILITIES		
Outstanding cheques less cash in bank	**36,068**	2,783
Note payable	**5,000**	5,000
Accounts payable and accrued liabilities	**49,798**	49,525
Advance billings and payments	**5,277**	5,002
Accrued interest	**23,033**	22,689
	119,176	84,999
	948,591	912,601
REINVESTED EARNINGS	**87,355**	71,910
	$1,035,946	$ 984,511

THE MANITOBA TELEPHONE SYSTEM

STATEMENT OF OPERATIONS AND REINVESTED EARNINGS FOR THE YEAR ENDED DECEMBER 31, 1988

	12 Months Ended December 31, 1988	9 Months Ended December 31, 1987 (Note 3)
	(in Thousands of Dollars)	
OPERATING REVENUES		
Long distance service	**$ 253,741**	$ 169,867
Local service	**166,049**	116,532
Miscellaneous (Note 6)	**34,775**	23,929
	454,565	310,328
OPERATING EXPENSES		
Operations and administration	**188,268**	123,120
General	**61,576**	33,814
Depreciation	**118,635**	93,994
Operating taxes (Note 7)	**12,294**	6,771
	380,773	257,699
NET EARNINGS FROM OPERATIONS	**73,792**	52,629
OTHER REVENUES (Note 8)	**19,269**	14,133
NET EARNINGS BEFORE DEBT CHARGES	**93,061**	66,762
DEBT CHARGES (Note 9)	**77,616**	64,815
NET EARNINGS FOR THE PERIOD	**15,445**	1,947
REINVESTED EARNINGS, AT BEGINNING OF PERIOD	**71,910**	69,963
REINVESTED EARNINGS, AT END OF PERIOD	**$ 87,355**	$ 71,910

See accompanying notes to financial statements.

THE MANITOBA TELEPHONE SYSTEM

STATEMENT OF CHANGES IN FINANCIAL POSITION FOR THE YEAR ENDED DECEMBER 31, 1988

	12 Months Ended December 31, 1988	9 Months Ended December 31, 1987 (Note 3)
	(in Thousands of Dollars)	
CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES		
From operations		
Net earnings for the period	**$ 15,445**	$ 1,947
Cash provided by (used for) changes in working capital	**349**	(10,545)
Add Depreciation and other items not requiring cash (net)	**150,618**	112,208
Payments toward deferred employee benefits	**(899)**	(1,068)
Total cash provided by operating activities	**165,513**	102,542
CASH PROVIDED BY (USED FOR) FINANCIAL ACTIVITIES		
Issuance of long-term debt	**22,000**	100,000
Repayment of long-term debt	**(25,000)**	(65,000)
Sinking fund withdrawals	**3,000**	3,600
Contribution to sinking fund	**(9,870)**	(7,037)
Total cash provided by (used for) financial activities	**(9,870)**	31,563
CASH USED FOR INVESTMENT ACTIVITIES		
Construction program expenditures (net)	**(149,387)**	(129,533)
Increase in investments held for pension obligations	**(34,953)**	(13,098)
Total cash used for investment activities	**(184,340)**	(142,631)
DECREASE IN CASH	**(28,697)**	(8,526)
CASH, AT BEGINNING OF PERIOD	**38,829**	47,355
CASH, AT END OF PERIOD	**$ 10,132**	$ 38,829

Cash represents cash and short term investments net of outstanding cheques.

See accompanying notes to financial statements.

THE MANITOBA TELEPHONE SYSTEM

NOTES TO FINANCIAL STATEMENTS DECEMBER 31, 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

a. General

The Manitoba Telephone System is incorporated by virtue of the provisions of The Manitoba Telephone Act, as a Crown Corporation of the Province of Manitoba.

The Manitoba Telephone System follows accounting practices similar to those used by other Telecom Canada members.

b. Telecommunications property

Telecommunications property is recorded at original cost including materials, direct labour and overhead costs which vary with the level of construction. In addition, telecommunications property includes the cost of funds used to finance the construction, based on the duration of the projects.

c. Depreciation

Depreciation is calculated on a straight-line basis over the estimated useful life of telecommunications property by applying rates which are based on a continuing program of engineering studies.

When depreciable telephone property is retired, the original cost of such property, adjusted by any disposal proceeds and costs of removal, is charged to accumulated depreciation.

d. Translation of foreign currencies

Foreign currencies have been translated into Canadian funds at rates of exchange on the following basis:

i) long-term debt at rates prevailing at year-end;
ii) accrued interest at rates prevailing at year-end;
iii) debt charges at rates prevailing at the date of each transaction.

The unrealized gains and losses resulting from the policy of using rates prevailing at year-end is being amortized over the remaining term of the debt on a straight-line basis.

e. Pension expense

The Manitoba Telephone System records as its pension expense the total of the actual disbursements made each year to its retired employees plus an amount approved by the Board of Commissioners to be invested in a fund entitled Investments Held For Pension Obligations.

f. Sick leave vesting

The initial cost of the Sick Leave Vesting plan, which became effective June 1, 1977, is being amortized on a straight-line basis over fifteen years. The annual sick leave entitlements subsequent to June 1, 1977 are being accrued and charged to expense in the year to which they relate. Payments to employees on termination are being charged to the deferred liability.

g. Amortization of bond premiums and discounts in sinking fund investments

Bond premiums and discounts arising from the purchase of bonds at other than face value are amortized over the remaining life of the bond.

h. Amortization of long-term debt costs

Costs associated with the issuance of long-term debt are being deferred and amortized over the term of the original issue.

2. CHANGE IN ACCOUNTING POLICY

To remain consistent with recent changes to the capitalization policies of other Telecom Canada companies, certain costs associated with installing, reconnecting or reinstalling station apparatus, including inside wiring, for business and residence station connections are being expensed on a prospective basis, commencing January 1, 1988.

Expenditures of $11,261,118 for station connection costs incurred during the year were charged directly to Operations and Administration expense. In addition, the remaining $3,094,945 of undepreciated investment as at December 31, 1987, was fully depreciated in 1988. Consequently, total expense for station connections amounted to $14,356,063 in 1988 ($16,319,435 — 9 months ended December 31, 1987).

The original cost of the buildings, plant and equipment and the related accumulated depreciation of $87,144,545 was removed from the balance sheet.

THE MANITOBA TELEPHONE SYSTEM

3. CHANGE IN YEAR-END

In accordance with Order-In-Council 1197/87, dated October 14, 1987, the fiscal year-end of The Manitoba Telephone System was fixed at December 31 in each year. Because of this change, the comparative figures on the statements of operations and reinvested earnings and changes in financial position are for a nine month period.

4. INVESTMENTS

	1988	1987
	(in Thousands of Dollars)	
Telesat Canada 99,900 common shares, at cost	**$999**	$999

5. DUE FROM SUBSIDIARY

Included in accounts receivable is a balance of $256,408, (December 31, 1987 — $509,000) due from MTX Telecom Services Inc. (MTX), a wholly owned subsidiary. This amount represents the net assets of MTX as of December 31, 1988.

6. MISCELLANEOUS OPERATING REVENUES

	12 Months Ended December 31, 1988	9 Months Ended December 31, 1987
	(in Thousands of Dollars)	
Directory advertising	**$24,203**	$17,462
Rentals and attachments	**7,215**	4,969
Other	**3,357**	1,498
	$34,775	$23,929

7. OPERATING TAXES

This category represents grants to municipalities in lieu of property taxes, The Manitoba Telephone System's portion of Canada Pension Plan and Unemployment Insurance, the Health and Education Levy, Federal Telecommunications Service Tax and general levies.

8. OTHER REVENUES

	12 Months Ended December 31, 1988	9 Months Ended December 31, 1987
	(in Thousands of Dollars)	
Investment income	**3,847**	$10,396
Surcharge on overdue accounts	**2,310**	1,605
Interest charged to construction	**1,338**	1,051
Miscellaneous, net	**1,774**	1,081
	$19,269	$14,133

9. DEBT CHARGES

	12 Months Ended December 31, 1988	9 Months Ended December 31, 1987
	(in Thousands of Dollars)	
Interest on long-term debt	**$74,306**	$57,550
Amortization of unrealized foreign currency losses	**1,508**	5,866
Amortization of long-term debt costs	**797**	652
Other interest expense and debt charges	**1,005**	747
	$77,616	$64,815

10. PENSIONS

a. Pension expense

Employees of The Manitoba Telephone System are pensionable under the Civil Service Superannuation Fund (the Fund) and make contributions to the Fund at prescribed rates. The Manitoba Telephone System is required to pay 50% of the pension disbursements made to retired employees. These pension payments are charged to general expense in the year of the disbursements. For the year ended December 31, 1988, The Manitoba Telephone System charged $7,366,000 to expenses as a result of such disbursements.

10. PENSIONS (Continued)

In addition, the Board of Commissioners approved contributions totalling $34,953,000 (including investment income of $4,030,000) to a fund entitled Investments Held for Pension Obligations, of which $30,098,000 has been charged to pension expense. The total charge to expense for pensions, excluding amounts capitalized, for the year ended December 31, 1988 is $36,285,000 (9 months ended December 31, 1987 — $15,149,000).

b. *Investments held for pension obligations*

Investments held for pension obligations are recorded at cost, unless there is a permanent impairment in the value of the investments.

The market value of investments at December 31, 1988 totalled $98,166,000 (December 31, 1987 — $61,229,000).

The investments are administered by external investment managers.

c. *Pension liability*

Based on a formula contained in an actuarial report prepared as of December 31, 1986, The Manitoba Telephone System had a liability for pension obligations as at December 31, 1988, of approximately $232,000,000 (December 31, 1987 — $207,000,000). This liability is based on the assumption that future pensions will be increased due to increases in the cost of living.

THE MANITOBA TELEPHONE SYSTEM

11. LONG-TERM DEBT

a) Advances, note and bonds payable

	Outstanding at rates prevailing December 31, 1988	Outstanding at rates prevailing December 31, 1987
	(in Thousands of Dollars)	
Province of Manitoba advances		
Series 10V, 9 3/4%, due December 1, 1988	**$ —**	$ 25,000
*Series BG, 9.375%, due August 2, 1990	**100,000**	100,000
Series 11E, 14 3/4%, due July 1, 1991 (40.0 million U.S. Dollars)	**47,708**	51,992
Series 11J, 15 1/4%, due March 31, 1992	**40,000**	40,000
Series AN, 11 1/2%, due May 15, 1995	**50,000**	50,000
Series UFA1, 11%, due November 5, 1995	**55,000**	55,000
Series AX, 7 4/5%, due May 20, 1996	**64,092**	64,092
Series UFA2, 9 13/25%, due September 26, 1996	**65,600**	65,600
**Series BC, 8 1/2%, due February 5, 1997	**87,500**	87,500
Series 10T, 9 3/4%, due May 15, 1998	**12,090**	12,090
Series 11A, 10 1/4%, due August 1, 1999	**5,000**	5,000
Series 9X, 10%, due December 5, 1999	**10,000**	10,000
	536,990	566,274
Note payable		
Province of Manitoba note, 11.35%, due May 23, 1989	**22,000**	—
The Manitoba Telephone System bonds payable		
Debentures fully guaranteed by the Province of Manitoba		
Series 1J, 7 3/4%, due February 15, 1989	**10**	10
Series 1M, 8%, due September 15, 1989	**108**	108
Series 1E, 5%, due January 15, 1991 (14.5 million U.S. Dollars)	**17,294**	18,847
Series 1N, 7 7/8%, due November 15, 1991	**20,000**	20,000
Series IF, 6 1/4%, due December 1, 1991	**20,000**	20,000
Series 1V, 5%, due January 3, 1992 (80.0 million Swiss Francs)	**63,544**	81,816
Series 1G, 7%, due February 15, 1993	**20,000**	20,000
Series 1P, 7 7/8%, due March 15, 1993	**10,000**	10,000
Series 1T, 10%, due July 2, 1995	**10,000**	10,000
Series 1U, 10 1/2%, due May 1, 1996	**20,000**	20,000
Series 1S, 8 3/4%, due March 1, 1999	**37,000**	37,000
	217,956	237,781
	$776,946	$804,055

* After 1990, extendable at the option of the bond holder
** Retractable February 5, 1990

11. LONG-TERM DEBT (Continued)

b) Sinking fund

Under the requirements of The Manitoba Telephone Act, The Manitoba Telephone System is required to pay a contribution to the Minister of Finance of the Province of Manitoba, as trustee for the sinking fund. The Sinking Fund contribution for the year ending December 31, 1988 was $9,870,000 (9 months ended December 31, 1987 — $7,037,000). The market value of the investments held in the fund at December 31, 1988 is $63,299,329 (December 31, 1987 — $56,457,453).

The following payments will be required to meet sinking fund conditions and debt retirements:

Year ending December 31	Sinking Fund Payment	Debt Retirement
	(in Thousands of Dollars)	
1989	$10,115	$ 22,118
1990	10,517	187,500
1991	8,799	105,002
1992	7,058	103,544
1993	6,067	30,000

c) Refinancing

It is the intention of The Manitoba Telephone System to refinance its maturing long-term debt, and accordingly all such debt is presented as a long-term obligation.

12. LEASE COMMITMENTS

The Manitoba Telephone System rents buildings, construction and other equipment, under operating leases. The aggregate annual rental of the commitments under the leases, which expire at varying dates to December 31, 1993, are:

1989	$3,334,640
1990	1,892,262
1991	1,056,106
1992	667,414
1993	377,812

13. COMPARATIVE FIGURES

The 1987 figures have been reclassified where necessary to conform to 1988 presentation.

THE MANITOBA TELEPHONE SYSTEM

FIVE YEARS IN REVIEW

(Not subject to auditors' report)

STATEMENT OF OPERATIONS	12 Months Ended December 31, 1988	9 Months Ended December 31, 1987	12 Months Ended March 31 1987	1986	1985
(in Thousands of Dollars)					
Total operating revenues	**$ 454,565**	$ 310,328	$ 379,319	$ 349,382	$ 326,330
Total operating expenses	**380,773**	257,699	324,934	282,916	265,443
Other revenues	**19,269**	14,133	16,751	17,231	15,283
Debt charges	**77,616**	64,815	91,127	84,735	60,978
Extraordinary item	**—**	—	—	27,110	—
Net earnings (loss)	**15,445**	1,947	(19,991)	(28,148)	15,192
BALANCE SHEET					
(in Thousands of Dollars)					
Telephone plant	**$1,503,519**	$1,468,737	$1,379,826	$1,257,934	$1,132,271
Accumulated depreciation	**688,368**	692,406	642,123	571,517	501,892
Investments and sinking funds	**165,750**	123,492	104,263	123,737	103,817
ong-term debt	**776,946**	804,055	753,325	690,151	557,915
Reinvested earnings	**87,355**	71,910	67,563	87,554	115,702
TELEPHONE STATISTICS					
Plant investment per main telephone	**$ 2,811**	$ 2,774	$ 2,690	$ 2,504	$ 2,320
Main telephones in service	**534,819**	529,408	512,984	502,286	487,440
Main telephones added during the period	**5,411**	16,424	10,698	14,846	15,549
(a) Average daily local calls (in thousands)	**5,779**	5,482	5,342	4,910	4,562
(b) Average daily long distance calls (in thousands)	**288**	266	251	235	215
OTHER STATISTICS					
Salaries and wages (in thousands)	**$ 160,284**	$ 115,585	$ 146,978	$ 139,822	$ 129,012
Number of employees	**5,212**	5,064	5,046	4,899	4,660
Employees per thousand main telephones	**9.7**	9.6	9.8	9.8	9.6
Long-term debt percentage of total invested capital	**89.0**	90.9	91.0	87.5	82.0
Debt charge coverage ratio	**1.2**	1.0	.8	.9	1.3
Gross construction expenditures (in thousands)	**$ 159,928***	$ 132,776	$ 166,060	$ 153,154	$ 112,721

*Excludes station connections

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